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No. 83-932

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

TEXAS INTERNATIONAL AIRLINES, INC.,
Petitioner,

v.

NATIONAL AIRLINES, INC.,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

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RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

When a statutory insider reaps short swing profits through the purchase and voluntary sale of common stock for cash within the period proscribed by Section 16(b) of the Securities Exchange Act of 1934,

(a) does the fact that the transactions arose out of a corporate control contest warrant review of the lower courts' determination, consistent with the express statutory language and judicial precedent, not to inquire into the insider's access to or abuse of inside information; and

(b) may the insider escape liability by asserting a defense of "equitable estoppel" based on subsequent events even though (i) the equities weigh against the insider and (ii) all courts addressing the question have uniformly held that equitable defenses are legally insufficient in actions under Section 16(b)?

LIST OF PARTIES

The names of all parties to the proceeding are contained in the caption.

Respondent National Airlines, Inc. was merged into Pan American World Airways, Inc. Pan American World Airways, Inc. has no parent company. Other than wholly-owned subsidiaries, the subsidiaries and affiliates of Pan American World Airways, Inc. are:

Company	*Incorporated Under Laws Of*
Acerias Paz Del Rio, S.A.	Colombia
Aeronautical Radio, Inc.	Delaware
Agropecuaria Fluminense, S.A.	Brazil
Air Cargo, Inc.	Delaware
Air Carrier Supply, Inc.	Florida
Airline Tariff Publishing Co.	District of Columbia
Ariana Afghan Airlines, Ltd.	Afghanistan
Companhia Hoteleira Novos Horizontes, S.A.	Brazil
Delsud Inversora, S.R.L.	Argentina
Escola Americana de Rio De Janeiro	Brazil
Hadrian, Ltd.	Bermuda
Honolulu Fueling Facilities Corp.	Hawaii
International Aeradio (Caribbean) Ltd.	Trinidad
Liberian Development Corp.	Liberia
Manhattan Air Terminal, Inc.	New York
New York Airways, Inc.	Delaware
Private Investment Company for Asia, S.A.	Panama
Promotora de Hoteles de Turismo Medellin, S.A.	Columbia
Radio Aeronautica Paraguaya, S.A.	Paraguay
Social Immobiliaria Norte America, S.A.	Argentina
Societe International de Telecommunications Aeronautiques	Belgium

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Respondent National Airlines, Inc. ("National") respectfully requests that this Court deny the petition for a writ of certiorari seeking review of the decision of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The September 15, 1983 opinion of the Court of Appeals is reported at 714 F.2d 533 (5th Cir. 1983) and appears in Appendix A to the petition ("Pet. App. A") at page 1a. The May 11, 1981 Memorandum and Order of the District Court is unreported and appears in Appendix B to the petition ("Pet. App. B") at page 1b. The District Court's May 10, 1982 final judgment appears in Appendix D to the petition at page 1d.

JURISDICTION

The judgment of the Court of Appeals was entered on September 15, 1983. The petition for a writ of certiorari was filed on December 6, 1983. Jurisdiction is invoked under 28 U.S.C. § 1254(1) (1976).

STATUTORY PROVISIONS INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982), provides, in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months.

The term "such beneficial owner" in Section 16(b) is defined in Section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a) (1982), as "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to Section 12 of this title. . . ."

STATEMENT OF THE CASE

The petition seeks review of an opinion and judgment of the United States Court of Appeals for the Fifth Circuit affirming the District Court's grant, in part, of National's

motion for summary judgment finding Texas International Airlines, Inc. ("Texas International") liable under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982).

On March 14, 1979, incident to its attempt to gain control of National, Texas International purchased 121,000 shares of National common stock in open market transactions. At that time, Texas International beneficially owned more than 10 percent of National's common stock. Within six months of that purchase, on July 28, 1979, Texas International elected voluntarily to sell its aggregate holdings of National common stock to Pan American World Airways, Inc. ("Pan Am"), a competing suitor for control of National. On that date, Texas International entered into an agreement to sell those shares to Pan Am in a two-step cash transaction. The first closing was held on July 30, 1979, at which time Pan Am paid $39,535,000 for 790,700 shares (or $50 per share) of Texas International's stock in National.[1] Under the matching rules of Section 16(b), the 797,700 shares were deemed to include the 121,000 shares Texas International had purchased just four and one-half months earlier.

Notably, Texas International's determination to effect that sale preceded by more than five months the eventual merger of National with Pan Am in January 1980. In fact, at the time Texas International chose to enter into the transaction with Pan Am, the fate of that proposed mer-

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[1] Pursuant to the agreement, Pan Am also paid Texas International $3,000,000 for the right to purchase Texas International's remaining holdings of National stock. At a second closing in November 1979, Pan Am exercised that right and purchased Texas International's remaining 1,309,300 shares for $63,465,000.

ger was still undecided. Although Pan Am had become a majority shareholder of National, the consummation of the proposed merger was conditioned upon, among other things, the securing of various governmental consents and approvals. As of July 28, 1979, these had not been obtained, and, as Texas International's Chairman of the Board admitted in an affidavit filed with the District Court, Pan Am had "good reason to fear" that it might not obtain satisfactory approvals. Thus, in determining to sell its National stock to Pan Am, Texas International made a calculated business decision immediately to reap a substantial profit on its National shares, rather than to risk holding the shares for the remainder of the six month period or pending the outcome of the proposed merger.[2]

Five days after the July 28, 1979 sale, Texas International brought suit in the District Court seeking declaratory relief that its sale of National stock did not fall within the ambit of Section 16(b). On November 26, 1979, National counterclaimed, seeking recovery of Texas International's short swing profits under Section 16(b). National moved for summary judgment on November 24, 1980.

On May 11, 1981, the District Court granted National's motion in part, finding that Section 16(b) was applicable to Texas International's purchase and sale of the 121,000 shares. The District Court rejected Texas International's contention that its voluntary sale of stock for cash was an

[2] Contrary to its assertions, Texas International did not "bow to the inevitable" at the time it sold its National shares. Interestingly, the fact of the merger agreement between Pan Am and National, dated September 6, 1978, had not deterred Texas International from making further purchases of National stock, including the 121,000 shares purchased in March 1979 at issue here.

"unorthodox transaction" within the meaning of *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973)("*Kern County*"). (Pet. App. B at 7b-8b.) Finding the three factors that trigger automatic Section 16(b) liability to be present—Texas International was a ten percent beneficial owner that purchased and sold stock within a six-month period—the District Court held Texas International liable to National for the short swing profits earned on the 121,000 shares. (Pet. App. B at 9b.) On May 10, 1982, the District Court entered final judgment awarding National $1,149,195 on its counterclaim, together with prejudgment interest and costs.

The Court of Appeals affirmed by a vote of 2-1. Adhering to the statements of legislative purpose as expressed by this Court and other courts, the Court of Appeals stated that "the mechanical application of Section 16(b) to the specified class of transactions is necessary in order to guarantee that the abuse at which the statute is aimed will be effectively curbed." (Pet. App. A at 10a.) Agreeing with the District Court, the Court of Appeals decided that Texas International's voluntary cash-for-stock transaction was not "unorthodox" under *Kern County*. (Pet. App. A at 11a.) Thus, the Court of Appeals determined that the question whether Texas International had access to inside information was irrelevant. (Pet. App. A at 11a.) The Court of Appeals appropriately rejected Texas International's attack on the unorthodox transaction test as "fundamentally flawed" because Texas International failed to distinguish between the involuntary character of the transaction in *Kern County* and the "volitional character of the exchange" in this case. (Pet. App. A at 12a-13a.)

Drawing on an unbroken line of precedent, the Court of Appeals further held Texas International's defense of

equitable estoppel insufficient as a matter of law. (Pet. App. A at 6a.) Moreover, observing that Texas International had "voluntarily decided to sell its shares to Pan Am before the merger," the Court of Appeals added that, in any event, it was "unconvinced that the equities favor [Texas International]." (Pet. App. A at 8a.)

ARGUMENT

The Decision of the Court Of Appeals Is Plainly Consistent With Prior Decisions of This Court and Lower Courts and Presents No Important Issues for Review.

A.

The Court of Appeals did not misunderstand *Kern County*. Rather, *Kern County* and its progeny make clear that this case was correctly decided by the Court of Appeals and presents no important issues for review.

Kern County approved a narrow exception to the general rule of automatic Section 16(b) liability, a rule based on the broadly remedial purpose of the provision. *Kern County* teaches that when a transaction is "unorthodox," a pragmatic approach that considers the possibility for speculative abuse and inquires into the insider's access to inside information and the voluntariness of the transaction is appropriate. *Id.* at 596-601. Under this approach, a court determines whether or not the unorthodox transaction should be deemed to be a Section 16(b) "purchase" or "sale." However, in the case of orthodox transactions, Section 16(b) liability is automatically imposed, without regard to the possibility of speculative abuse.

In *Kern County*, the Court stated that "traditional cash-for-stock transactions . . . are clearly within the purview of Section 16(b). . . ." *Id.* at 593. In determining that the transaction before it was unorthodox, this Court emphasized that the "[t]he critical fact is that the ex-

change took place and was required pursuant to a merger." *Id.* at 599. But this Court added that:

> Occidental could, of course, have disposed of its shares of Old Kern for cash before the merger was closed. Such an act would have been a § 16(b) sale and would have left Occidental with a prima facie § 16(b) liability.

Id. at 600.

Following *Kern County*, courts have uniformly held that a "pragmatic" or "flexible" inquiry into access to information or possibility for speculative abuse is inappropriate unless the transaction is unorthodox and the meaning of "purchase" or "sale" is therefore in issue. *See, e.g., Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries*, 527 F.2d 335, 351 (7th Cir.), *cert. denied*, 423 U.S. 1078 (1976); *Lewis* v. *Varnes*, 505 F.2d 785, 789 (2d Cir. 1974); *Gold* v. *Sloan*, 486 F.2d 340, 342-43 (4th Cir. 1973), *cert. denied*, 419 U.S. 873 (1974).

Moreover, courts have consistently declined to characterize cash-for-stock transactions as "unorthodox." *See, e.g., Oliff* v. *Exchange International Corp.*, 669 F.2d 1162, 1167-68 (7th Cir. 1980), *cert. denied*, 450 U.S. 915 (1981); *Lane Bryant, Inc.* v. *Hatleigh Corp.*, 517 F. Supp. 1196, 1200-01 (S.D.N.Y. 1981); *Tyco Laboratories, Inc.* v. *Cutler-Hammer, Inc.*, 490 F. Supp. 1, 5-7 (S.D.N.Y. 1980); *Cutler-Hammer, Inc.* v. *Leeds & Northrup Co.*, 469 F. Supp. 1021, 1022-24 (E.D. Wis. 1979). *Contra Pier I Imports of Georgia, Inc.* v. *Wilson*, 529 F. Supp. 239, 243 (N.D. Tex. 1981). Courts have also found cash-for-stock transactions none the less orthodox for having stemmed from a hostile takeover battle. *See Lane Bryant, Inc.* v. *Hatleigh Corp.*, 517 F. Supp. at 1201; *Tyco Laboratories, Inc.* v. *Cutler-Hammer, Inc.*, 490 F. Supp. at 6.

Consistent with this precedent, the Court of Appeals correctly decided that Texas International's cash-for-stock transaction was not unorthodox and, accordingly, that inquiry into Texas International's access to inside information was inappropriate. (Pet. App. A at 11a.) In rejecting Texas International's attack on the unorthodox test, the Court of Appeals observed that Texas International failed to consider the significance of the volitional nature of its acts in light of *Kern County*. (Pet. App. A at 12a.) The Court of Appeals concluded that, since Texas International voluntarily entered into the stock purchase agreement with Pan Am before the merger between Pan Am and National, no valid basis existed for an exception to Section 16(b) liability.[3]

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[3] The dissenting Court of Appeals judge recognized that the majority's interpretation of *Kern County* was "certainly consistent with the 'weight' of the law as it exists," yet nevertheless believed that Texas International should not be found liable under *Kern County*. (Pet. App. A at 16a-17a.) The dissent considered the hostile takeover situation to be more of an "unorthodox" than a traditional transaction and, under such circumstances, "would not make any distinction between a cash-for-stock and a stock-for-stock sale." (Pet. App. A at 19a.)

This reasoning, as the majority suggests, also ignores the significance of voluntariness in *Kern County*. In *Kern County*, a defeated takeover contestant was forced to enter into a stock-for-stock exchange pursuant to a merger; this Court declined to apply Section 16(b) to such an involuntary transaction. *See* 411 U.S. at 600.

Similarly, Texas International's reference to Judge Friendly's opinion in *Abrams* v. *Occidental Petroleum Corp.*, 450 F.2d 157, 163-4 (2d Cir. 1971), *aff'd sub nom. Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), overlooks the fact that Judge Friendly specifically tailored his remarks to a situation involving a forced merger, unlike the voluntary cash sale here.

B.

Policy considerations will not support the rewriting of Section 16(b) to create the new exception urged by Texas International for takeover contestants who voluntarily elect to sell their stock for cash. The policy rationale underlying the objective standards of Section 16(b) is not overridden simply because the transaction arose out of a corporate control contest. Congress chose a strict liability standard as the only effective means of curbing the evils of insider trading.[4] Clearly, the Court of Appeals adopted a purpose-oriented approach faithful to Congress' determination not to embroil the courts in problems of proof regarding access to or abuse of inside information. (Pet. App. A at 9a-10a.) It is equally clear that the purpose of Section 16(b) can only be preserved by applying its objective standards to voluntary orthodox transactions, including those stemming from hostile takeover contests.[5] Thus, the Court of Appeals' approach was wholly

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[4] This Court has explained the need for such objective standards. *See Reliance Electric Company* v. *Emerson Electric Company*, 404 U.S. 418, 422 (1972).

[5] It is not difficult to envision that, after becoming a statutory insider, a contestant in a takeover struggle could obtain inside information that would allow it to buy shares and then sell them at an advantageous price or time to a competing bidder or other willing purchaser. For this reason, creating the wholesale exception to Section 16(b) for control contestants Texas International sponsors is fraught with danger to the continued efficacy of Section 16(b). Although the means Congress chose to address the evils of insider trading may cover instances where those evils are not present, the courts have recognized that the statute's prophylactic goals must take precedence. *See, e.g., Gratz* v. *Claughton*, 187 F.2d 46, 50 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951); *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 239-40 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

consonant with, and indeed based upon, sound policy considerations.

Moreover, contrary to Texas International's suggestion, the present case is unusual and unlikely to recur.[6] The reasons for this are readily apparent. A takeover contestant who is defeated or abandons the fight can either wait six months from its last purchase before selling or wait until the target's merger with another party is effectuated. If six months pass, there obviously is no Section 16(b) liability. If the contestant is forced to exchange stock in the target company pursuant to the target's merger with a third company within the six month period, the transaction would, under *Kern County*, be viewed as "unorthodox" and, because of its involuntary nature, no Section 16(b) liability would attach. *Kern County*, then, amply protects prudent takeover contestants from unjustified liability.

For this reason, and again contrary to Texas International's assertions, Section 16(b)'s applicability in takeover contests does not hurt the climate of investor and shareholder opportunity sought by the Williams Act, 15 U.S.C. §§ 781-n (1982). Thus, the Court of Appeals' decision will have no chilling effect on legitimate transactions, and this case, although perhaps important to Texas

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[6] Indeed, although hostile takeover contests have proliferated within the last decade, the incidence of voluntary cash sales by contestants within the period proscribed by Section 16(b) is notably rare. In fact, our review of reported decisions reveals few instances involving such voluntary, orthodox transactions. *See, e.g., Lane Bryant, Inc.* v. *Hatleigh Corp.*, 517 F. Supp. at 1200; *Tyco Laboratories, Inc.* v. *Cutler-Hammer, Inc.* 490 F. Supp. at 1, 5-7. In those cases, the courts concluded, as did the Court of Appeals here, that the cash-for-stock sale by a defeated takeover contestant resulted in automatic Section 16(b) liability.

International, is of no real public moment worthy of consideration by this Court.

C.

In rejecting Texas International's attempt to interpose the defense of equitable estoppel, the Court of Appeals drew on and reaffirmed well established case law. Courts, mindful of the remedial purpose of the statute, have uniformly held that equitable defenses are insufficient as a matter of law in Section 16(b) actions. *See, e.g., Tyco Laboratories, Inc.* v. *Cutler-Hammer, Inc.*, 490 F. Supp. at 8; *Cutler-Hammer, Inc.* v. *Leeds & Northrup Co.*, 469 F. Supp. at 1023; *Newmark* v. *RKO General, Inc.*, 294 F Supp. 358, 367 (S.D.N.Y. 1968), *aff'd*, 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970); *Perfect Photo, Inc.* v. *Grabb*, 205 F. Supp. 569, 572 (E.D. Pa. 1962). Indeed, courts have not entertained equitable defenses even when the issuer itself instigated the transaction, *see, e.g., Magida* v. *Continental Can Co.*, 231 F.2d 843, 846 (2d Cir.), *cert denied*, 351 U.S. 972 (1956), or participated in the transaction as purchaser of the stock. *See, e.g., Roth* v. *Fund of Funds, Ltd.*, 405 F.2d 421, 422-23 (2d Cir. 1968), *cert. denied*, 394 U.S. 975 (1969). Nor have courts barred recovery by shareholders of the issuer even though they benefit from the disgorgement of profits.

Similarly, the Court of Appeals properly disallowed equitable defenses in this Section 16(b) case, recognizing that a contrary ruling would serve only to erode the remedial design of the statute. (Pet. App. A at 6a.)[7] Since the Court of Appeals' decision was sound and consistent

[7] Indeed, as the Court of Appeals recognized, it would be anomalous to allow an insider to retain short swing profits by reason of a subsequent event—the merger between National and Pan Am more than five months after the proscribed transaction. (Pet. App. A at 6a,

with all prior case law, there is no cause for this Court to review the issue.[8]

This case in any event does not provide an appropriate occasion to consider whether equitable defenses should ever be permitted in Section 16(b) actions. This is not a case where a party with equity plainly on its side was denied an estoppel defense as a matter of law. To the contrary, as the Court of Appeals observed, the equities of the situation here do not favor Texas International and

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8a.) Although Texas International suggests that its defense is not based on the merger, Pet. at 16 n.3, its assertion disregards the fact that its "defense" is premised on Pan Am's interest, as the successor to National by merger, in the recovery awarded below.

[8] Texas International is unable to cite any Section 16(b) case in which equitable defenses were recognized. In citing dicta from *American Standard, Inc.* v. *Crane Co.*, 510 F.2d 1043, 1061 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975), Texas International glosses over the fact that the holding there was premised on a finding that the transaction at issue was unorthodox—a forced sale pursuant to a merger.

Moreover, Texas International's reliance on *Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co.*, 417 U.S. 703 (1974), is misplaced. In that case, Bangor & Aroostook R.R. ("BAR") brought suit against Bangor Punta alleging mismanagement and waste of BAR's corporate assets during the period Bangor Punta controlled BAR. BAR sought damages based on alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, as well as of federal antitrust law and state law. At the time of suit, Amoskeag Co. owned 99% of BAR's stock, having purchased 98.3% of it from Bangor Punta. Amoskeag had not been a BAR shareholder during the period of Bangor Punta's alleged mismanagement of BAR.

This Court held that Amoskeag, as a shareholder of BAR, was estopped from complaining of Bangor Punta's alleged wrongs. This Court's decision depended upon "the settled principle of equity that a shareholder may not complain of acts of corporate mismanagement if

allowing it to escape liability under the circumstances would result in "a pure windfall to [Texas International]." (Pet. App. A at 8a.) Texas International voluntarily decided to sell its shares of National to Pan Am prior to the merger, fully anticipating the probable applicability of Section 16(b). Accordingly, this is the wrong case to consider any modification of the established rule that equitable defenses are insufficient as a matter of law in Section 16(b) actions.

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he acquired his shares from those who participated or acquiesced in the allegedly wrongful transactions." *Id.* at 710. Since Amoskeag had purchased substantially all its shares of BAR from Bangor Punta, permitting it to recover for Bangor Punta's prior mismanagement of BAR would have violated this established equitable principle. *Id.* at 710-12, 717 n.13.

This Court further held that since Amoskeag would be the principal beneficiary of any recovery, and was itself estopped, it "[could not] avoid the command of equity through the guise of proceeding in the name of [BAR] which it owns and controls." *Id.* at 713. Accordingly, BAR was precluded from bringing the action.

Bangor Punta did not involve Section 16(b), and the "settled principle of equity" guiding this Court's decision in *Bangor Punta* has no applicability to the present action. *Bangor Punta* is therefore inapposite to this case and provides no support for the proposition that Section 16(b) actions may be barred by equitable defenses.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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